

03-00071

MEMORANDUM:

TO: David Foster, Tennessee Regulatory Authority

FROM: Mike Whitten

Mike Whitten

SUBJECT: Memphis Network Agreed Upon Procedures Review Report

DATE: March 10, 2004

David,
As requested, attached are seven copies of the report prepared by Warren Averett for the period of inception through 12/31/2002.

Please let me know of any questions or comments, and your thoughts on similar work for the period ended 12/31/2003.

Thanks!

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TN REGULATORY AUTHORITY
TELECOMMUNICATIONS DIVISION

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T.R.A. COMM. DIV.

WARREN, AVERETT, & KIMBROUGH & MARINO, LLC

Certified Public Accountants • Business & Financial Consultants

INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON PROCEDURES

January 23, 2004

Board of Directors
Memphis Gas, Light & Water Division
Memphis, TN 38130-3917

We have performed the procedures enumerated below, which were agreed to by Memphis Light, Gas & Water Division (MLGW) and Memphis Networkx, LLC and the Board of Directors of Memphis Light, Gas & Water Division, solely to assist you with respect to the accounting records of Memphis Light, Gas & Water Division and Memphis Networkx, LLC for the time period of August 9, 2001 through December 31, 2002. This engagement to apply agreed-upon procedures was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified parties of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

Agreed-Upon Procedure

1. Determine whether MLGW has charged an amount for pole attachments and underground installations to Memphis Networkx equal to the highest rate charged by MLGW to any other person or entity for comparable attachments.

Findings

Of the five sample contracts for pole fees that we reviewed, we were able to recalculate the pole fee based on wording in the contract and agree to the pole fee that is currently being charged. The wording in the fifth contract merely states "rental rate shall be reviewed and adjusted every three years." The contract does not specify a method of review or an adjustment amount. For this reason, we were unable to recalculate the pole fee. However, the current pole fee being charged appears reasonable based on the other four sample contracts that we reviewed.

The highest annual pole fee being charged is \$18.71 and the highest rate per foot for an annual conduit fee is \$3.66. Memphis Networkx is currently being charged \$18.01 as an annual pole fee and \$2.75 as an annual conduit fee per foot. While Memphis Networkx

amounts are not equal to the highest rate, the contract renewal periods are not identical. Therefore, the variance could be caused by a timing difference.

Agreed-Upon Procedure

2. Determine whether the interest costs for funds lent to the Telecommunications Division by MLGW to acquire, construct, and provide working capital for the system, plant and equipment are allocated at a rate not less than the highest rate earned by MLGW on invested electric plant funds.

Findings

We found no findings or exceptions as the result of the above procedure. The monthly interest percentage being charged on funds lent to the Telecommunications Division is exactly the same as the corresponding interest rates on invested funds.

Agreed-Upon Procedure

3. Determine whether MLGW and Memphis Networx have separate employees.

Findings

We found no findings or exceptions as the result of the above procedure. No employees were noted to have been employed concurrently by both MLGW and Memphis Networx.

Agreed-Upon Procedure

4. Determine whether costs of MLGW have been properly allocated to its Telecommunications Division.

Findings

Our procedures revealed that the amounts on the annual report filed with the Tennessee Regulatory Authority (TRA) and the costs allocated to the Telecommunications Division by MLGW did not agree. Upon further inspection, it was determined these variances stemmed from timing differences. The following chart outlines the difference between the amounts allocated by MLGW to the Telecommunications Department and the amounts displayed on the TRA report for each period.

	August – December 2001		January – December 2002	
	MLGW	TRA	MLGW	TRA
Labor	\$49,265.43	\$32,268.99	\$82,473.99	\$66,518.89
Legal	66,712.33	67,432.43	3,800.57	3,800.57
Travel	1,244.79	524.69	2,077.92	2,057.93
Horrell Communications	23,000.00	23,000.00	55,200.00	55,200.00
Interdepartmental Rents	0.00	3,996.00	8,279.00	6,773.00
Transfer Charges	0.00	0.00	(19.99)	0.00
A & G Allocation (3.4%)	<u>4,767.57</u>	<u>4,325.55</u>	<u>5,161.59</u>	<u>4,567.91</u>
Total	\$144,990.12	\$131,547.66	\$156,973.08	\$138,918.30

The largest variance relates to labor cost allocated to the Telecommunications Division. At quarter end, each employee is required to determine the percentage of time he or she spent on telecommunications work for that quarter. Since the allocation percentage for a quarter is not determined until after the quarter has ended, time is initially allocated based on the prior quarter's percentage. If the percentage changes from one quarter to the next, an adjustment is made in the subsequent quarter to adjust the time allocated to the Telecommunications Division. This procedure can cause allocated labor expense to be incorrect for up to four months before the adjusting entry is recorded. All time entries should be adjusted to the correct rate for the corresponding quarter so the errors are merely timing differences. However, since the TRA report was prepared using the actual quarterly percentages, there is a large discrepancy between the two reports. Even though this difference could be explained as a timing difference, we found the discrepancy to be too large. We feel that reporting would be more correct if all adjusting entries were made before year end closing.

The difference in legal and travel expenses in the 2001 period is due to an error in reporting on the TRA statement. Expenses totaling \$720.10 were inadvertently moved from the travel segment to the legal segment when the report was filed. This mistake did not cause a difference in the total expenses reported, and therefore we did not find an exception with it.

The other timing variance we discovered related to labor costs as discussed above. Since employee benefit costs (included in the labor category), interdepartmental rents, and administrative costs are allocated as a percentage of total costs, the calculations resulted

in different amounts. By correcting the above timing issue, this variance would also be corrected.

Agreed-Upon Procedure

5. Determine whether any other expenses of MLGW have been charged to its Telecommunications Division and, if so, determine whether such charges are in compliance with the cost allocation manual.

Findings

We found no findings or exceptions as the result of the above procedure. Expenses being allocated to the Telecommunications Division include administrative and general costs, labor, legal, travel, and consulting. All the expenses were allocated as defined in the cost allocation manual.

Agreed-Upon Procedure

6. Determine whether MLGW has billed Memphis Networkx the appropriate tariff rates for electric, gas and water services provided to Memphis Networkx.

Findings

In December of 2001, Memphis Networkx moved from 7555 Appling Center Drive to 7620 Appling Center Drive. We found no findings or exceptions as the result of the above procedure at the initial location of 7555 Appling Center Drive. At the second location of 7620 Appling Center Drive, we found no findings or exceptions in relation to the water or electric rates applied. However, a clerical error occurred in establishing the gas tariff rates at the new location. The gas service was inadvertently established at the residential rate instead of the business rate. This error was discovered by MLGW staff on April 1, 2003 and was corrected at that time. Accordingly, the amounts shown on the financial reports for the period in question have not been corrected. The following is a chart showing the difference between the amount billed and the amount that should have been billed.

	<u>Amount per gas</u> <u>bill</u>	<u>Corrected</u> <u>Amount</u>	<u>Difference</u>
December 2001	\$ 150.02	\$ 168.95	\$ 18.93
January 2002	465.44	496.72	31.28
February 2002	1,022.55	1,072.32	49.77
March 2002	1,277.89	1,336.13	58.24
April 2002	1,347.53	1,408.08	60.55
May 2002	1,479.07	1,543.98	64.91
June 2002	1,920.11	1,999.67	79.56
July 2002	1,889.16	1,967.69	78.53
August 2002	1,920.11	1,999.67	79.56
September 2002	1,951.06	2,031.64	80.58
October 2002	1,618.35	1,687.88	69.53
November 2002	1,432.64	1,496.02	63.38
December 2002	1,927.85	2,007.66	79.81
Additional amount due to MLGW			\$ 814.63

Agreed-Upon Procedure

- Determine whether the amounts billed by MLGW to Memphis Network for non-tariffed services, specifically make ready work and engineering, are appropriate.

Findings

We found no findings or exceptions as the result of the above procedure. All amounts on the summary of non-tariffed services agree appropriately to underlying documentation and all calculations were correct. The amounts on the summary sheet agreed to the invoices, the TRA annual report, and the MLGW general ledger.

Agreed-Upon Procedure

- Determine whether any revenues of MLGW have been allocated to its Telecommunications Division and, if so, determine the reasonableness of the allocation.

Findings

We found no findings or exceptions as the result of the above procedure. No revenue has been allocated to the Telecommunication Division.

We were not engaged to, and did not, perform an audit, the objective of which would be the expression of an opinion on the specified elements, accounts, or items. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the specified parties and is not intended to be and should not be used by anyone other than these specified parties.

Warren, Averett, Kimbrough + Marino, LLC